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INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

GUIDANCE PAPER FOR FIT AND PROPER PRINCIPLES AND THEIR APPLICATION

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Guidance Paper for Fit and Proper Principles and their Application

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1. Introduction

1. The fit and proper principles are sensitive issues in many jurisdictions and their application may vary according to the legal and political climate of the jurisdiction. For these reasons this paper is for guidance only.

2. Background

2. The Joint Forum has prepared a paper on "fit and proper principles" as it applies to conglomerates, which was endorsed by IAIS in San Francisco in December 1999.

3. However, the paper does not address the issue of fit and proper principles in relation to single entities, nor in relation to groups of companies within a single discipline, e.g. insurance. Accordingly, this paper extends the scope of the Joint Forum paper and contains a section on the application of those fit and proper principles in relation to insurance entities.

4. For the purposes of this paper, 'insurance entities' can be defined as any corporate body or individual which is operating as an insurer, reinsurer or insurance intermediary and which is subject to insurance regulation.

5. The fit and proper principles contained in the Joint Forum paper on conglomerates can be extended easily to insurance entities. Insurance entities may be simpler to assess because the competency requirements cover only a single industry.

3. Objective

6. The objective of this paper is identical to that in the Joint Forum paper. It is repeated below, amended to refer to the regulation of insurance entities.

7. To ensure that supervisors of insurance entities are able to exercise their responsibilities to assess whether insurance entities are soundly and prudently managed and directed and that key functionaries (directors, managers, shareholders and others who exercise a material or controlling influence over the affairs of the insurance entity) do not pose a risk to the interests of present and future policyholders and beneficiaries of these entities.

8. On a case-by-case basis and when requested by other insurance supervisors, to promote arrangements to facilitate consultation between supervisors and the exchange of information on individuals and regulated insurance entities, to achieve the above.

4. Fit and Proper Principles

9. The Joint Forum paper lists seven principles, which are noted below, adapted in relation to insurance entities. Principles 5, 6 and 7 of the Joint Forum paper, have been combined below as one principle.

4.1 Necessity

10. In order to assist in ensuring that supervised insurance entities are operated prudently and soundly, fitness and propriety or other qualification tests should be applied.

4.2 Subjects

11. These tests should be applied to key functionaries (directors, managers, shareholders and any other persons exercising a material or controlling influence on the management, operations or shareholding of supervised insurance entities – sometimes termed "controllers"). Certain jurisdictions may require that these tests also be applied to other senior employees (for example, underwriters, financial controllers, treasurers, etc).

4.3 Timing

12. Fitness, propriety or other qualifications tests should be applied at the authorisation stage and thereafter, on the occurrence of specified events.

4.4 Responsibility

13. Supervisors' expectations are that insurance entities will take the measures necessary to ensure that fitness, propriety or other qualification tests are met on a continuous basis.

4.5 Supervisory Cooperation

14. In cases where key functionaries are known to have connections in other jurisdictions, supervisors should communicate with those supervisors in the relevant jurisdictions as part of the assessment procedure.

a. Supervisors should contact the insurance supervisors in the jurisdictions concerned. However, if an individual (or corporation) has been working outside the insurance sector but in a regulated financial services sector in another jurisdiction, it may also be necessary to exchange information with the supervisor in that other sector;

b. Where there is no direct channel to a supervisor in another jurisdiction, it may be possible to route information to the relevant domestic supervisor (of the key functionaries) for onward transmission;

c. Supervisors' "reach" may not extend to other entities in the group which are regulated by supervisors in other jurisdictions, or to unregulated entities in the parent group. In such cases, supervisors should be aware that measures taken to apply fitness, propriety or other qualification tests to such entities may create the false impression that supervision generally extends to those other (or unregulated) entities.

d. Most countries have legislation in place protecting the privacy of individuals and accordingly it is recognised that there may be limitations to a free exchange of information between supervisors.

e. It may be that arrangements to exchange information between supervisors should be formalised in agreements, e.g., Memoranda of Understanding, to establish a framework for the efficient transfer of such information.

5. General Statements

15. The Joint Forum paper contains a large number of statements of suggested practice. For the purposes of this paper, certain of these have been incorporated below (amended and summarised), to outline the general approach to which insurance supervisors should have regard. However, for completeness of statement and intent, reference should always be made to the Joint Forum paper.

a. Insurance supervisors may be subject to statutory and other requirements in applying fitness, propriety or other qualification tests to the insurance entities under their jurisdiction. It is not

intended that such statutory and other requirements (as well as procedures for the application of those tests) should be superseded by the principles and applications set out in this paper.

b. An effective and comprehensive supervisory regime should include controls designed to encourage the continued satisfaction of the fitness, propriety or other qualification tests of supervisors and to allow supervisory intervention where necessary.

c. Supervisors should have at their disposal various sanctions to ensure remedial measures are taken in respect of key functionaries who do not meet the relevant fitness and propriety or other qualification standards. An appropriate appeals process should be made available to individuals affected by remedial determinations made against them.

d. When acquiring responsibilities and powers in new areas of the provision of financial services, (e.g. in circumstances of new or changed legislation), the supervisor may take into consideration evidence of past performance of insurance entities and their key personnel.

e. Supervisors should be aware that, as concerns the functions and responsibilities of directors and officers, there are significant differences in legislative and regulatory frameworks from country to country. In some countries, there is a two tier board system consisting of a supervisory board which has a main function of supervising the management board. Thus, the supervisory board has no executive functions. In other countries, with a unitary board system, the board has a broader responsibility. In this regard, fitness, propriety or other qualification tests should be applied to directors in the light of their role and responsibilities.

f. It is recognised that in addition to the factors identified in the previous paragraphs, the assessment of fitness, propriety and other qualifications may be a judgmental matter and that supervisors may have additional information at their disposal that they can consider on a case-by-case basis.

g. It is recognised that an individual considered fit for a particular position within an institution may not be considered fit for another position with different responsibilities or for a similar position within another institution, and conversely, an individual considered unfit for a particular position in a particular institution may be considered fit in different circumstances.

6. Application of the Fit and Proper Principles

6.1 Individuals

16. In determining whether individuals are fit and proper to hold the position of shareholder, director, officer or manager, in an insurance entity a supervisor shall consider:

a. whether the individuals have sufficient skills, knowledge and soundness of judgement to undertake and fulfil the particular duties and responsibilities;

b. the relevant competence, diligence and soundness of judgement of the individuals, including previous experience, track record, qualifications and training;

c. the individuals reputation and character;

d. in respect of soundness of judgement, the degree of balance, rationality and maturity demonstrated in conduct and decision-taking, including whether they have engaged in, or been associated with, any unsatisfactory business practices;

e. generally, whether the interests of policy owners, insurance claimants, customers and creditors of the insurance entity are in any way threatened by the individuals occupying the position.

17. In addition, the individuals should not have a record or evidence of previous business conduct and activities where individuals have:

a. been convicted for an offence under any legislation designed to protect members of the public from financial loss due to dishonesty, incompetence or malpractice;

b. engaged in any business practices appearing to be deceitful or oppressive or otherwise improper, whether unlawful or not, or which otherwise reflect discredit on the individuals methods of conducting business;

c. been a party to any action or decision of the board or management of the insurance entity, which was detrimental to the interests of the entity, and if appropriate, its policy holders.

18. The individuals should also have achieved a satisfactory outcome as a result of security and financial vetting:

a. Security vetting may be undertaken with the help of law enforcement agencies (usually a government or police anti-fraud authority), who will carry out their own investigations with the relevant authorities, to establish if there is any criminal record involving fraud, criminal breach of trust, forgery and other criminal offences, eg relating to dishonesty. Information required of an Individual applicant, for the purposes of security and financial vetting, is provided in Annex 1;

b. The supervisor in the country of origin of the business operation should be contacted to ascertain whether there are records of non-compliance, contravention of the statutory acts and regulation, non-cooperation, industry misconduct, etc.

c. Financial vetting with the financial supervisory authorities may be undertaken. Such information will demonstrate whether there is any financial misconduct, improper conduct of financial accounting with financial institutions, bad loans, record of corruption activities or whether the applicant has been judged to be a bankrupt.

d. The supervisor may require that insurance entities have in place policies for self-assessment and may have reserve powers to remove unfit or improper individuals.

19. If necessary, an interview could be conducted with the prospective applicant.

20. Once an insurance entity is authorised, the supervisor should continue to take account of performance of all relevant individuals:

a. imprudence in the conduct of business, or actions which have threatened the interests of policy holders will reflect adversely on the competence and soundness of judgement of those responsible;

b. failure by an insurance entity to conduct its business with integrity and professional skills will reflect adversely on the probity, competence, and soundness of judgement of those responsible. This applies whether the matters of concern have arisen from the way the individuals responsible have acted or from their failure to act in an appropriate manner;

c. assessment of the significance of such actions or omissions should be a cumulative approach; that is, the supervisor may judge that an individual does not fulfil the criterion on the basis of several instances of such conduct which, if taken separately, might not have led to such a conclusion.

6.2 Corporate Institutions

21. Corporate institutions are sometimes shareholders and or directors and officers (i.e. key functionaries) in insurance entities. In these cases the test and evaluation of fit and proper principles should also be applied to these institutions.

22. In the broad test of fitness and probity for institutions, insurance supervisors should look for evidence that the institutions meet a high standard by reviewing the following:

a. their financial soundness and strengths;

b. the nature and scope of their business;

c. the key functionaries;

d. the group structure (if applicable) and organisation chart.

23. Where necessary and where the corporate institutions are regulated entities in another jurisdiction the insurance supervisor should seek confirmation from the relevant regulators that the institutions are in good standing in that other jurisdiction.

Annex I

Information Required for the Purpose of Security and Financial Vetting of an Individual

This annex contains a selection of information that an insurance supervisor may ask for to be submitted for assessment purposes. The annex is meant for guidance only and it is for the supervisor concerned to select the appropriate questions. Local data protection laws of certain countries may not permit some of the following information to be requested, retained or disclosed. In such situations, the supervisor should seek to obtain as much relevant information as is legally permitted, to enable a judgement to be formed on the suitability of the individual for that position.

- Name (and any previous names):
- Private and business address (including any other private addresses within the last 15 years), current telephone, fax and e-mail addresses:
- Date and place of birth:
- Nationality (and any previous nationality):
- Passport/identity card:
  - Number:
  - Date and place of issue:
  - Issuing authority:
- Name and address of bank:
  - Account numbers and type of account:
  - Details of any loans or guarantees issued to or on behalf of the company in which the applicant has a management or shareholding interest.
- Family status:
- Details and dates of academic qualification:
- Details and dates of professional qualification:
- Description of the prospective position (including responsibilities) and proposed date of commencement:
- Working experience:
  - Existing and previous employers (covering the last 15 years):

- Details of whether the applicant and / or his employers have been formally supervised or regulated
- Nature of employer's business
- Designation:
  (including duties and responsibilities)
- Date of appointment:
- Date of resignation / departure:
- Reason for resignation / departure.
- Details of other business interests in the last 15 years where the applicant has been a working shareholder, director or controller.

- Relationship with the company and other third parties:-
  - Details of shareholdings or voting powers in the company, related or third parties:
  - Details of any business relationships with the company, related or third parties:
  - Details of any business relationship between the applicant's former employers and the company, related or third parties:

- Full details on the applicant's reputation and character:-
  - Whether the applicant has ever been declared bankrupt;
  - Any convictions of any offence involving fraud or other dishonesty;
  - Any disqualification of the applicant from acting as a director or in the management of any company or organisation;
  - Whether the applicant has ever been refused (or had revoked) a licence or authorisation to carry on any regulated financial business;

- Any censure or disciplinary action initiated by any governmental, regulatory or professional body;

- Any dismissals from office or employment, subjection to disciplinary proceedings by the applicant's employer or been refused entry to any profession or occupation;

- Any litigation with which the applicant has been involved over the last 5 years;

- Whether any governmental, regulatory or professional body has ever investigated any employer, company or organisation with which the applicant has been associated with as a director, officer, manager or shareholder;

- Whether any company or organisation with which the applicant was associated as a director, officer, manager, shareholder or controller has ever been wound up, gone into receivership or

ceased trading either whilst the applicant was associated with it or within one year after the applicant so ceased to be associated.